New terms for sharing credit

Version 2.0 of co-lending is set to rise, but its earlier avatar continues to cast a shadow, report **RAGHU MOHAN & ABHIJIT LELE**

ILLUSTRATION: AJAYA MOHANTY

Almost seven years after it was rolled out, the Reserve Bank of India (RBI) has hit the reset button on co-lending. The new draft framework goes beyond banks and non-banking financial companies (NBFCs) to cover all regulated entities (REs), and segments outside priority-sector loans.

Will version 2.0 fire?

The reality is that co-lending did not take off because banks and NBFCs had to dance around issues after blowouts in shadow banking, and iron out the finer aspects of the model. And even now, there's no data from Mint Road on the outstanding loans under this arrangement. A report by Crisil put NBFCs' assets under co-lending as nearing ₹1 trillion at end-December 2023; another by Icra put it at ₹50,000 crore in FY24. But both numbers are not to be taken as the total assets under this facility of banks and NBFCs.

The pain points

"I think everybody is struggling. Fundamentally, it means your underwriting standards should be aligned with those of the originator: NBFCs," says a candid Prashant Kumar, managing director (MD) and chief executive officer (CEO) of Yes Bank. Asked if the draft framework addresses these issues, he points to the fact that it now covers arrangements across all REs and segments. Or take microfinance institutions, some of whom are under stress. As Jiji Mammen, executive director and CEO of Sa-Dhan — the self-regulatory body for the business — views it, the risk appetite of the partners will be different and "accordingly, will opt for their share in the arrangement. The perception of each entity will also reflect in their individual pricing."

So, how do REs get on the same page?

A model document may have to be worked out to be agreed upfront between them. For example, banks are more comfortable funding fleet operators and NBFCs are happier with new-to-credit commercial vehicle owners. Banks service largely out of branches; NBFCs are fine with field decisions. Just that the differences will cover a wider lot of REs here on. Again, the RBI has made it clear that since the borrower remains the same, if an RE classifies its exposure as non-performing, the same shall be applicable to other RE too.

Ultimate responsibility

The other aspect to be factored is the RBI's master direction on 'Managing Risks and Code of Conduct in Outsourcing of Financial Services'. It's categorical that outsourcing of any activity by an RE does not diminish its obligations, as also that of its board/senior management, which have the ultimate responsibility for the outsourced activity. That REs must ensure the service provider employs the same high standard of care while performing the services as would be employed by them — that is if the activities were conducted by the REs and not outsourced.

Then, there is the issue of the first-loss default guarantee (FLDG) — where its issuer compensates another in a lending relationship for the first losses incurred on a loan portfolio due to defaults, up to a predetermined percentage. It is capped at five per cent now. Shachindra Nath, founder and MD of UGRO Capital, says: "We have been asking for uniformity between digital lending-business correspondent arrangement and co-lending. Given that FLDGs have been allowed, it will make banks open up to co-lending because the spread they would allow to NBFCs would ensure that they have minimal credit cost."

According to Gaurav Gupta, founder, MD & CEO of Tyger Capital (the erstwhile Adani Capital): "There is little difference between the interest charged by banks and NBFCs for co-lending. If banks are now going to ask for FLDG, will the lending rate be lower?"

Put differently, FLDGs involve a cost to the issuer (it's a contingent liability): how is it to be factored in co-lending? Remember, the borrower pays a blended rate; and to the extent FLDG is in play, its issuer has to make it good. The irony here is that a section of REs was all along for FLDGs even as Mint Road was a bit wary of the product: the fear being REs will seek comfort through FLGDs, rather than put their skin in the game, and this may run counter to its view on outsourcing in the master direction.

Co-lending version 2.0 will go through birth pangs.

RBI REGULATIONS OVER THE YEARS

- **July 2014:** Norms set for how banks engage business correspondents
- **Sep 2018:** Co-origination business model between banks and NBFCs introduced
- **Nov 2020:** Banks get to co-lend individual loans, back-to-back basis, with NBFCs
- **Sep 2022:** Digital lending formalised as a new category of outsourcing
- **June 2023:** Guidelines set for sharing credit losses between partners
- **April 2025:** Framework set for co-lending and sourcing arrangements

Source: RBI, Icra Research

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MD & CEO, Yes Bank

"Based on risk appetite, perception of each entity will reflect in their pricing"

JIJI MAMMEN
ED & CEO, Sa-Dhan

"FLDGs will make banks open up to co-lending as it ensures they have minimal credit cost"

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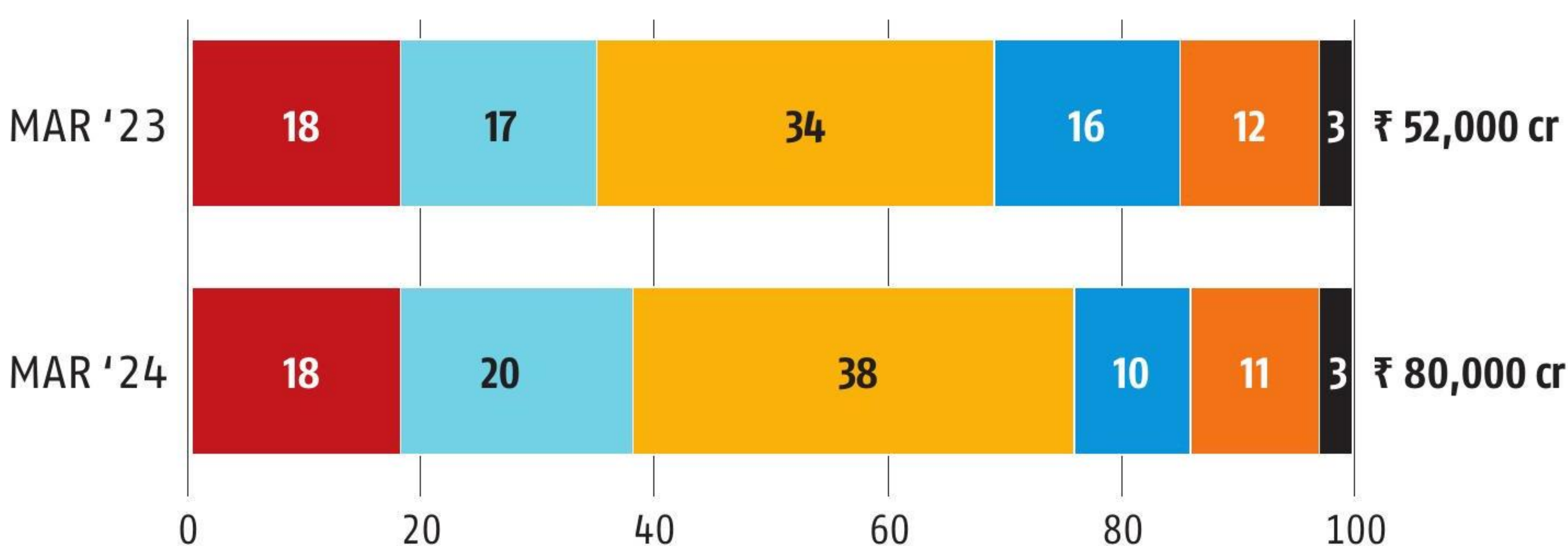
GAURAV GUPTA
Founder, MD & CEO, Tyger Capital

CO-LENDING AUM OF SMALL & MEDIUM NBFCs

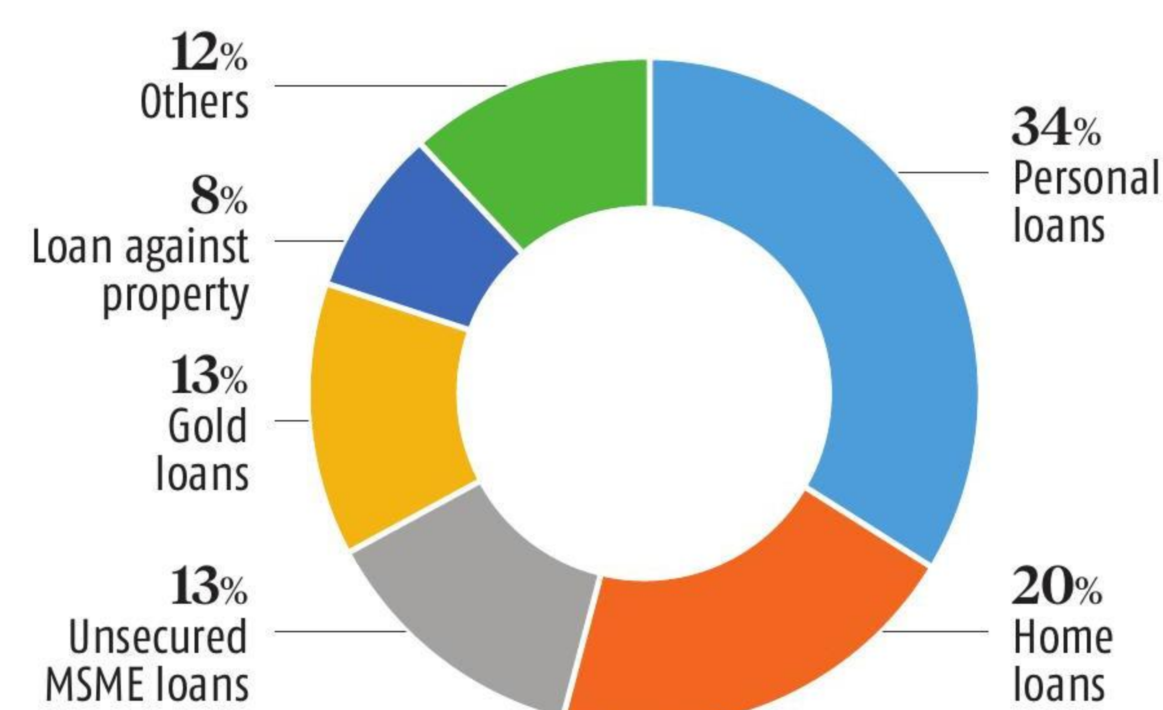
Home loans | SME | PC/CL | Gold | LAP | Vehicle (%)



Notes: AUM is assets under management; NBFC is non-banking financial company; SME is small and medium enterprises; PL/CL is personal/ consumption loans; LAP is loan against property

Source: RBI, Icra Research

COMPOSITION OF CO-LENDING AUM*



*As on Dec 31, 2023

Source: Company data; CRISIL Ratings